Global Reinsurance Forum

January 14, 2013

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland
Sent by email to: fsb@bis.org

Re: Response to FSB's Consultative Document, "Strengthening Oversight and Regulation of Shadow Banking"

To the Financial Stability Board:

On behalf of the Global Reinsurance Forum (GRF), whose membership accounts for 64% of the net reinsurance premiums written by the top 40 global reinsurers, the GRF welcomes the opportunity to comment on the three consultative documents, "Strengthening Oversight and Regulation of Shadow Banking" – henceforth the "Consultative Documents" – prepared by the Financial Stability Board (FSB) and issued on 18 November 2012. The GRF commends the FSB for its consideration of the five specific areas for policies to mitigate the potential systemic risks posed by shadow banking and welcomes the open and consultative approach taken by the FSB in this report.

The GRF concurs with the FSB that authorities' approach to shadow banking should be targeted and address bank-like risks to financial stability while not inhibiting sustainable non-bank financing models that do not pose such risks. In particular, the GRF fully endorses the statement in the Consultative Document that, "Where non-bank financial entities have specialized expertise in assessing risks, they may provide these functions in a cost-efficient manner, and provide competition, innovation and lower borrowing costs. And where non-bank credit intermediation takes forms which do not involve maturity transformation or leverage – for instance through direct investment in long-term credit instruments by institutions such as insurance companies or pension funds – (such intermediaries) can increase the resilience of the financial system." Thus, GRF supports the view of the FSB that the differences between traditional bank-based securitization structures and insurance-linked securities (ILS) structures put in place by reinsurers should be considered.

We urge the FSB to remain mindful in its analysis and its writings that reinsurance companies are not banks and therefore reinsurers warrant different treatment than banks. The difference between banks and reinsurers is significant when applying criteria such as interconnectedness to other financial service providers and the presence of systemic risk. As the IAIS concluded in its 19 July 2012 report on Reinsurance and Financial Stability, "we find that traditional reinsurance – including the reinsurance of peak risks – is unlikely to contribute, or amplify, systemic risk." Simply stated, reinsurers do not pose risk to the system, they reduce risk present in the system.

It may also be useful to note, that since issue of the 18 November, 2012, FSB Consultative Documents, the Geneva Association, a leading international insurance think tank, published a cross industry analysis between 28 G-SIBs versus 28 of the world's largest insurers on indicators of systemic risk. This research represents the first empirical and quantitative comparison of insurers and banks using the comparable criteria required by the International Association of Insurance Supervisors' (IAIS) data calls.

The conclusions of that Geneva Association factual analysis strongly support the recommendations in the FSB Consultative Documents in four critical respects:

- Insurers are significantly smaller than banks. The average bank's assets are 3.9 times larger than the average insurer and the largest insurer would rank alongside only the 22nd largest systemically important bank. Furthermore, as insurance liabilities are substantially matched against their assets, an insurance balance sheet is much less systemically risky than that of a bank of comparable size.
- Insurers write considerably fewer Credit Default Swaps (CDS) than banks. The average bank writes 158 times the value of gross notional CDS than the average insurer. Even the lowest ranked banks on average have 12.5 times the CDS sold by the average insurer.
- Insurers utilize substantially less short-term funding than banks. Short-term funding as a percentage of total bank assets is 6.5 times higher than short-term funding as a percentage of insurer assets. Maturity transformation is central to the business models of many banks and is a principle source of their systemic risk.
- Insurers are much less interconnected to other financial service providers than banks. Banks carry 219 times more gross derivative exposure than the insurer average with even the lowest ranked banks carrying 66 times more gross derivative exposure than the average insurer. On average, at the measurement date, banks owed on average 68 times more than insurers in gross negative derivatives and banks are also owed 70 times more from derivatives counterparties through derivatives exposure.

Indeed, within the past decade, both in the wake of many significant global catastrophic events and up to and through the financial crisis of 2008 to the present, reinsurers performed admirably, with capacity remaining at record levels.

Finally, in considering any possible policy measures, the GRF suggest the FSB and other authorities should keep several principles in mind: that any new or proposed measures should be proportionate to clearly identified risks, and should avoid unintended adverse consequences; that the measures should be directed at clearly identified sources of systemic importance and linked to the assessment methodology; and that the ultimate costs to consumers and to market participants of any proposed measure should be calculated and weighed in respect to the risks mitigated.

The GRF welcomes the opportunity to comment on the Consultative Documents and looks forward to further engagement with the FSB on these issues. Should you have any questions on the issues raised in this letter, please contact me by phone at or +1 (203) 832-0069 or by email at Edward.Heffernan@xlgroup.com.

Kindest Regards,

Edward Heffernan
Associate to the Chair
Global Reinsurance Forum